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Congressional Panel Critical Of Japan's Economic Policies

The Joint Economic Committee of Congress earlier this year gave it to the Reagan administration with both barrels for its handling of the economy. More recently, a report on West Germany criticized Germany's macroeconomic stance. So it came as no surprise that the committee's report on Japan would be sharply critical of Tokyo's policies.

The Reagan administration, while aiming to improve access for U.S. exporters to Japanese markets, has supported Japan's moves since early 1987 to expand its economy. Washington and Tokyo also have acted largely in concert since the Plaza Accord of September 1985 to support higher values of the yen.

percent real rise in GNP by itself would lead to only a 2 percent real expansion in imports from the United States. The increases from other countries, particularly the newly industrialized economies, are predicted to be far greater.

In the introduction to the committee's work, Sen. Paul Sarbanes (D, Md.) notes that the report is not intended to minimize the policy changes Washington needs to make to reduce the enormous U.S. current account deficit. Few, least of all Japanese policymakers, would disagree. The committee itself noted in a previous study that large federal budget deficits have reduced U.S. fixed nonresidential investment, a critical component of increased export or import-substitution capacity in the United States. That same red ink has also induced an inflow of Japanese and other foreign capital, which in turn has propped up the dollar and contributed to the persistence of trade imbalances.

Douglas Ostrom

Rising Yen Holding Down Japanese Prices

For years Japan was accused of deliberately preventing the yen from rising. The depressed currency kept exports healthy and imports low. Since the yen started soaring in 1985, however, the advantages of a high yen have become more apparent.

One of the positive attributes of a strong yen that Japan worries it would lose if its currency weakened is price stability. As the yen has risen, exporters to Japan have been able to lower their prices in yen while maintaining or even increasing profit margins in their own currency. Since Japanese distributors have not increased their margins dramatically, and have often reduced them, the result has been lower prices for consumers and industrial buyers (see JEI Report No. 25B, July 1, 1988).

But the benefits do not stop there. Domestic import-competing industries have to shave their prices in the face of increasing competition. If they are exporters, they face problems raising their prices in dollars because of competition overseas. If they cannot raise dollar prices to offset the yen's appreciation, yen-based export prices fall. Some of this may spill over into the prices charged domestic customers for export goods, partly because exporters may divert some production to the home market. The result should be three-sided price stability: of imports, import-competing goods and export goods sold domestically.

While far from conclusive, the Table suggests that at least some of these effects may have been present in recent years. Of course, many factors besides exchange rates influence price levels. However, as the yen has increased in value, import prices have fallen almost in lockstep, and declines in domestic prices, while smaller, have followed a similar pattern. The relationship is also evident in quarterly data.

The effect of falling import prices on domestic price levels may be increasing. The Bank of Japan has compared the recent period with an earlier interval when the currency was strong. For the same 40 goods in which foreign

suppliers and domestic producers competed, it found that the domestic goods declined in price 46 percent as much as imports between September 1985 and February 1988, while between December 1976 and October 1978 they averaged less than 40 percent of the decline in import prices. The bank concludes that competition between domestic and imported goods is becoming more intense.

Effect of Yen Appreciation on Prices

(1985 = 100)

	Yen/$ Exchange Rate	Import Prices	Domestic Wholesale Prices
1981	92.6	106.7	100.9
1982	104.6	115.1	101.4
1983	99.8	106.1	100.7
1984	99.8	102.5	100.8
1985	100.0	100.0	100.0
1986	70.6	64.2	95.3
1987	60.7	58.9	92.3

Source: Bank of Japan

For American producers, these changes, if they persist, are mostly good news. A strong yen will carry some weight, both to push import prices lower for Japanese buyers and to force import-competing Japanese firms into price reductions. In the longer run, Japanese exporters will find their domestic markets much less of a safe haven; attempts to maintain prices at home will be challenged by other exporters or even by importers. The resultant price stability will benefit Japanese consumers. Even many exporters will benefit to the extent that lower production costs at home offset some of the pain of the high yen in foreign markets.

Douglas Ostrom

Stock Affair Complicates Tax Reform's Chances

Embarrassingly profitable stock transactions may raise another political obstacle Prime Minister Noboru Takeshita must overcome before a sweeping tax reform plan can be enacted. Opposition parties are grasping at every straw in an effort to prevent passage of a 3 percent general consumption tax; they will surely try to turn the stock affair into a major confidence issue.

Personal aides to several political figures -- including Mr. Takeshita; Yasuhiro Nakasone, the previous prime minister; Kiichi Miyazawa, the finance minister, and Shintaro Abe, the secretary general of the Liberal Democratic Party -- and several private businessmen are said to have made unusually high profits from the sale of Recruit Cosmos Co., Ltd. shares. The shares initially were sold for Y1,200 each ($9.60 at Y125=$1.00) to 76 people, including the personal aides, when the company was strapped for cash in 1984. When the real estate firm went public two years later, the aides and others sold their shares